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Board Committees in European Companies

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Board Committees in European Companies

by Jeremy Bacon

A Research Report from The Conference Board's Management Functions Program

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Highlights

This report is based on descriptions of 40 committees reported by 18 companies in five countries: France, West Germany, the Netherlands, Sweden, and the United Kingdom. All are committees of the board, not management committees; in the case of Germany and the Netherlands this means the *supervisory* board. Thirteen interviews in four of these countries expanded on and clarified points suggested by questionnaire data provided by the cooperating firms.

The report shows that:

- The use of committees of directors to focus on some aspect of the board's responsibilities is a practice found to some degree in all five of the countries surveyed, even though boards differ in important respects from one country to the next.
- Most of the 18 companies reporting that they have a board committee have more than one (the average is 2.2).
- The three most common types of committee found in these 18 firms are remuneration (10), finance or credit (9), and audit (5).
- About two-thirds of these committees have a single or clearly predominant focus, as exemplified by the three types just mentioned. But some have been given rather general terms of reference or powers, or have at least two major areas of responsibility.
- The great majority of board committees reported are formal bodies with written job descriptions. Nevertheless, only a minority are mentioned in annual reports or other communications to shareholders.
- Every committee except two was established in 1970 or later; nearly half have been in existence only since 1980.
- Outside or nonexecutive directors are in the majority on most of the board committees studied.
- Advising the full board is the most commonly mentioned role of board committees in the sample, but close to a third can make at least some decisions on behalf of the board; fewer than a handful have the authority to set policy.

Why This Report

Language, politics, geography and tradition are just some of the obstacles that are being overcome as the market place becomes more thoroughly international. Increasingly, this shift is going beyond simply doing business across borders to encompass more cross-nationalization in the ownership of corporate entities. Just consider, for example, the profusion of subsidiary companies with faraway foreign parents.

These trends create a greater need to understand where authority is vested and how business decisions are reached and implemented in various foreign environments. While the significant national differences in the structure and role of boards of directors have been examined by The Conference Board, this particular report sheds new light on how directors, regardless of board form, exercise their responsibilities. The board committee, it turns out, is a practical concept that apparently crosses borders with little difficulty.

We are indebted to executives in five European countries who supplied information about practices in their firms. We also thank some of those executives and other experts who shared their knowledge and experience with us in interviews. Their cooperation exemplifies the support on an international basis that makes our research possible.

JAMES T. MILLS
President

Chapter 1
The Context

The purpose of the inquiry on which this report is based was to learn something about what kinds of committees are presently being used by boards of directors in Europe, why they have been established, what their functions are, and how much authority they have.[1] Other matters, such as the membership of these committees, were also explored. We believe that the resulting information adds dimension to the topic of board structure, which is often approached in academic or legalistic terms. And the information sheds light on how directors of European companies actually carry out their responsibilities.

The five countries selected for examination were the United Kingdom, France, West Germany, the Netherlands, and Sweden. Each of these countries has a distinctive approach to how a corporation's board of directors is structured. Apart from structural differences, there are also national differences in procedures and customs where boards are concerned. As background to the information about board committees that will follow, a brief treatment of some key country-to-country differences in board structures is included here.

In two countries—Sweden and the United Kingdom—only the single or unitary board is found. In a third country, France, the unitary board structure is decidedly most popular, and is used by the three French firms contributing to the report, but French law also permits the option of using a form of two-tier board system (a supervisory board and a management board). In West Germany and the Netherlands, one finds two-tier board structures, although each differs from the other and from the optional French system. The diagrams on page 2 show the structural configuration of boards (or supervisory boards) in the five countries.

Schematic representations cannot convey details, let alone nuances, of the underlying differences in custom, philosophy and politics that account for such variations in board structure. This is not the place for lengthy discussion of such details, but several comments concerning connections between board *structure* and board *committees* need to be made.

- In Germany and the Netherlands, the board of directors for purposes of this report is the *supervisory* board, not the management board.
- Since no executives or other employees serve on a Dutch supervisory board, it follows that there are *no insiders on any of the board committees* reported from that country.
- Similarly, since no members of the management board in German companies can serve on the supervisory board, it follows that *no members of top management will be found on committees of the supervisory board*. Such committees do include lower-level employees or union representatives who come from the employee "bench" that makes up one-half of the supervisory board.
- In Sweden, the president-chief executive is often the only member of management who serves on the board (along with two lower-level employees elected to the board by the union). *He is also, therefore, the only "insider" on many board committees in that country.*
- In the United Kingdom, despite the relatively large numbers of executive directors serving on boards there, the membership of "overview" or "monitoring" committees, *such as the audit or compensation committee, tend to have a majority of nonexecutive directors*. This is also true of *finance* committees reported from that country, for that matter.
- Supervisory boards in Germany and the Netherlands have only limited authority to act. By the same token, almost none of the supervisory-board committees reported in those countries has the power to act or decide on its own.

A word on terminology: the English-language terminology that has come into use for naming or describing European practices is misleading in some cases, and has perhaps contributed to confusion in making international comparisons. A primary example is the term "two-tier board," which suggests two bodies or groups that together make up a "board of directors," or that operate somehow in conjunction to have a single or complementary effect, or that spring from the same legal basis if in different forms. They are, in fact, very different bodies designed for different purposes. Not only does each differ from

[1] The various aspects of board-committee practices in the United States are the subject of continuing Conference Board research. A profile of current U.S. practices appears in the box on page 5.

the other within the same (national) system, but each also differs significantly from the boards of directors found in systems in most other countries.

This report, nevertheless, uses some of this commonly accepted terminology as a matter of convenience. Specifically, the term "supervisory board" is used to mean, both in Germany and the Netherlands, *not* the board or council that is responsible for managing the company but the "higher" body (in the sense that it can hire or fire the other group). And it is the supervisory board whose committees are examined in the context of this study; management committees of many kinds exist but are not the focus here.

Thirty-one companies, all large firms, returned completed questionnaires. Of these, 13 have no committees of the board and have no present plans to establish any. The 18 companies that do have committees at the board level have a total of 40 among them. Information submitted about those 40 committees is the basis for the numbers in the report.

Questionnaire information was augmented and clarified by 13 interviews, mostly with questionnaire respondents, but also with other knowledgeable people. In addition, a small number of documents (such as board resolutions) supplied useful data.

It should be emphasized that the limited size of the sample could not yield numerical data of any significance. At this point in time, the goal was to spot trends in practices, not to establish their numerical presence. Tabulations are used in this report, therefore, only to simplify presentation of the data and to make for easier comparisons between countries.

Board (or Supervisory Board) Structures in the Five Countries Considered in the Report

THE NETHERLANDS
Supervisory Board

All outside directors, who themselves choose new members (subject to veto by management or works council).

UNITED KINGDOM
Board of Directors

Traditionally a majority of inside (executive) directors although nonexecutive directors now outnumber executives on many boards.

FRANCE
Board of Directors (Conseil d'Administration)[1]

Minimum of two-thirds outside directors required. One-third or fewer are company executives.[2]

[1]Companies can also choose a structure with an all-outside "conseil de surveillance" (supervisory board) and a "directorate" or management board. Most use a conseil d'administration; all survey cooperators do.

[2]Up to four nonvoting nonmanagement employees may attend meetings.

WEST GERMANY
(For companies with more than 20,000 employees)
Supervisory Board

Ten outside directors, elected by shareholders; one is board chairman.

Seven nonmanagement employees plus three trade union representatives, elected by employees; one is deputy chairman.

SWEDEN
(For companies with more than 25 employees)
Board of Directors

A majority of outside directors required; board chairman cannot also be president (managing director).

A minority consisting of corporate executives (sometimes the president alone) plus, usually, two employee representatives elected by unions.

Chapter 2
Committee Prevalence

In 1977, The Conference Board published a comparative study of directorship practices in nine countries.[1] Four of those countries—France, Sweden, the United Kingdom, and West Germany—are also represented in the present survey. The 1977 report indicated that in the three continental European countries observed, the use of board committees was very much a minority practice. In France and Sweden, for example, the proportion of firms that reported having a committee of the board was 10 percent and 13 percent, respectively. And although 90 percent of the U.K. companies then had at least one committee of the board, it was the opinion of knowledgeable sources in that country that many of these committees were somewhat informal.

There is no statistical evidence of a major increase in the use of board committees in Europe, although *informal* evidence indicates at least a greater level of interest in board committees in the United Kingdom than previously.

Number of Board Committees

The 18 companies that reported on their board committees are rather evenly distributed among the five countries: three in France, three in Germany, three in the Netherlands, four in Sweden, and five in the United Kingdom. In terms of *numbers of committees* reported on in each country, the count is: six in France, seven in Germany, six in the Netherlands, six in Sweden, and 15 in the United Kingdom, for a total of 40.

The number of committees reported by individual firms ranges from one to as many as eight. A majority of companies have more than one board committee; the average is 2.2. A tabulation follows:

Number of Board Committees	Number of Companies Reporting
1	6
2	8
3	2
4	1
8	1

[1]Jeremy Bacon and James K. Brown, *The Board of Directors: Perspectives and Practices in Nine Countries*. The Conference Board, Report No. 728, 1977.

Types of Committees

The committees reported are readily divided into those that are found in more than one company (26), and those that are mentioned only once (14). The first group—compensation, finance, audit, and personnel committees—are listed in Table 1 on page 4.

Fourteen committees were reported in addition to those in Table 1. Of these, one does not have a formal title; the thirteen that do are listed below. These committees were reported by only one company each. A number of them, unlike the committees in Table 1, have a general or broad scope of duties rather than a predominant focus. The committees, listed by country, are:

France:	Comité d'Etudes (Management Advisory Committee), Comité de Direction
Germany:	Ausschuss für Vorstandsgelegenheiten
Netherlands:	Liaison Committee
Sweden:	Presidium, Committee for Electing a General Manager (temporary)
United Kingdom:	Chairman's Committee, Standing Committee, Group Executive Committee, Directors' Nominating Committee, Power of Attorney Committee, Share Option Committee, Special Committee

Degree of Formality

The committees for which information was reported are, on the whole, clearly formal rather than informal bodies. Respondents were asked whether the roles and powers of their committee(s) were set forth in writing in a board resolution or other document. Only six (all in the Netherlands and Sweden) of the forty reported committees do not have such a written charter.

On the other hand, only one-third of the companies name or describe their board committees in annual reports or other

Table 1: Board Committees Reported More than Once[1]

Type and Title of Committee[2]		Number of Companies Reporting Each Committee	
Remuneration:			10
France:	Comité des Traitements	1	
Germany:	Personnel Committee[a]	1	
Netherlands:	Remuneration (2), Compensation	3	
Sweden:	Salary Committee	1	
United Kingdom:	Compensation (2), Remuneration, Executive Director Remuneration	4	
Finance (including Credit, Investment, Exposure):			9
France:	Comité Consultatif des Engagements (Exposure), Comité Annual des Risques	2	
Germany:	Credit Committee, Bilanzausschuss, Investitionsausschuss	3	
Sweden:	Finance Committee (2)	2	
United Kingdom:	Finance, Finance and General Purposes Committee	2	
Audit:			5
France:	Comité des Comptes (Audit Committee)	1	
Netherlands:	Audit Committee, Special Committee	2	
United Kingdom:	Audit Committee (2)	2	
Personnel:			2
Germany:	Personalausschuss (2)[a]	2	
Total committees			26

[1]Committees in this table, in addition to being mentioned more than once, also have a single or predominant area of focus.
[2]Titles are given in the form supplied by respondents.
[a]These committees, according to indications from the respondents involved, do not appear to be the committee that is a legal requirement in Germany for dealing with disputes over management board appointments.

Table 2: When Board Committees Were Established

Years	Total Committees	By Country[1]			
		France	Netherlands	Sweden	United Kingdom
Before 1970[a]	5	2	2	—	1
1970-1974	5	1	—	—	4
1975-1979	6	1	1	2	2
1980-1985	14	2	2	3	7

[1]Figures not available for German committees.
[a]1 in 1930; 1 in 1953; 3 in 1969.

corporate information available to shareholders or to the public. (None of the companies in the Netherlands or Sweden makes such disclosures.) Thus, while the formal status of most committees indicates the importance of their function to the boards of directors involved, most of the cooperating companies do not inform the outside world of the committees' official status as organizational entities.

None of the committees reported and described by these companies was established because of a requirement of a law or regulation; the companies (or boards) created them at their own initiative, for reasons that are examined in the next section. (The reader will find a description of one kind of supervisory board committee that *is* required in some types of companies under German law in the box on page 8.)

Board Committees in the United States

Intentionally, almost no reference is made in the body of this report to practices in the United States. That is because U.S. laws, business customs, social and political systems, and experience differ markedly, for the most part, from those in the countries dealt with in the report. Although this is less true for the United Kingdom, where some firms have adopted certain board practices (the audit committee, for example) from across the Atlantic, U.K. boards remain quite distinctive in several key respects.

Nonetheless, the increased use of board committees is such a hallmark of changes in U.S. boardroom practices that a brief summary of that development might be of interest by way of comparison. A 1985 survey (of directors' compensation) highlights how ubiquitous board committees have become in the United States.[1] The 956 respondents to the survey provided information on what board committees they have. The respondents represent a cross section of industries and a wide range of sizes. Almost every company that responded—99 percent—has at least one committee of directors, and in fact most have several; the median number of committees per company among manufacturing and nonfinancial service firms is four; the median among financial firms is five. For the larger companies in all categories ($3 billion or more in sales or, for financial firms, assets), the median is five.

The five principal committees found in these U.S. companies, and their prevalence, were:

Committee	Percent of Companies with this Committee
Audit committee	97%
Compensation committee	85
Executive committee	71
Nominating (director selection) committee	50
Finance committee	28

(Only 45 percent of a sampling of similar scope done in 1972 had an audit committee; only 15 percent had a nominating committee as recently as 1977.)[2]

Why so many committees now, and in a relatively short time? Several developments have affected various committees. They include the following:

- **Endorsement by the Securities and Exchange Commission and the New York Stock Exchange**. Since as early as the 1930s, the Securities and Exchange Commission has championed audit committees of outside directors as a means of improving the dependability and quality of corporate financial information made available to the investing public. The SEC has even required such a committee as a condition for settling legal complaints against specific companies.

  Since 1978, the New York Stock Exchange has required that companies traded on that exchange (about 1,500 major firms, presently) have an audit committee composed of independent outside directors. Although the American Stock Exchange has officially come out in favor of audit committees, it does not require one.

- **Society's push for more independent boards**. The pressure for greater corporate responsiveness to a broad spectrum of constituents (not just shareholders) during the late 1960's and early 1970's led to a move toward boards of directors that were more independent of company management. The growth of the audit committee received an impetus from this trend, as did that of the nominating committee. The latter represents to some of its proponents a way of loosening management's traditional control over board appointments.

  An increase in the number of outside directors on boards—one of the main changes in the move toward board independence—helped make it possible to staff the new committees that were being formed. Most major U.S. firms now have a majority of outside directors.

  One important aspect of this trend toward board independence is a conviction that if corporations do not voluntarily improve their performance in being responsive to society and in being properly accountable for their actions, legislative solutions will be imposed.

- **Increased liability exposure**. Managers and directors of U.S. corporations have faced an escalation in legal suits brought against them in their roles as managers and board members. Many directors feel that board committees such as the audit, compensation and nominating committees have become all but necessary as proof of their diligence in monitoring corporate affairs. They also rely on committees to help them remain adequately informed.

[1]Jeremy Bacon, *Corporate Directors' Compensation, 1986 Edition*. The Conference Board, Report No. 877, 1985.

[2]Jeremy Bacon, *Corporate Directorship Practices: Membership and Committees of the Board*. The Conference Board, Report No. 588, 1973. Jeremy Bacon *Corporate Directorship Practices: Compensation 1977*. The Conference Board, Report No. 740, 1978.

When Committees Were Established

Table 2 shows that almost all of the committees found in the cooperating companies were constituted in the past 16 years. In fact, only two existed before 1969. The relative newness of these board committees means that they are a departure from traditional practice. But they are definitely no longer experimental; they are permanent standing committees, and are an integral part of the organizational structure and working procedures of these boards.

Chapter 3
Reasons For (and Against) Using Board Committees

A question pursued in interviews with cooperators was why their companies had decided to establish board committees. Three reasons account for most of the committees:

- The board had to address a serious real or potential problem facing the company;
- There was a need for the board to monitor, on a regular basis, a corporate activity; or
- External circumstances or influences suggested the use of a committee.

Some examples of these situations are given below. There is also a summary of reasons that were spelled out by cooperators for *not* using committees of the board.

Committees to Solve Problems

Two examples from the Netherlands illustrate formation of a board committee as a response to a specific problem. When a Dutch firm acquired a German company in the late 1960's, it proved difficult to devise a compensation scheme for the combined firms that would be acceptable to executives on both sides; the compensation philosophies and practices that had prevailed in the companies prior to merger were very different. A committee, composed of members of the supervisory board representing both merger partners, was formed to work out a mutually satisfactory solution. Once this specific problem had been solved, the committee continued to function as a remuneration committee.

The other example came about at a time when a Dutch company faced serious financial problems. There was a need during this crisis period to be able to make prompt decisions, yet the supervisory board was too unwieldy to convene speedily. So the board delegated some of its powers to a group from within the board that could meet on short notice and take action as required. Originally, this group did not have official status as a board committee. Eventually—partly because other board members became uncomfortable with the special power delegated to this group—the group was reconstituted as a formal board committee. Over time it has evolved to also become the company's audit committee.

Both of these examples involve committees that began as temporary or ad hoc committees but later acquired a more formal status as standing board committees. But other committees were cited that had (or will have) a limited, "life of the project" status. A Swedish company reports a board committee, established in 1985, whose purpose is to make a recommendation to the full board as to who the next general manager of the company shall be. Once it has accomplished this task, the committee will be dissolved.

Committees to Monitor a Particular Function

Some committees have come into being because members of the board or management, or both, recognized a need to keep continuing watch on some significant corporate function or activity. Examples cited by study cooperators are the audit committee, the finance committee (for banks, the credit committee), and the compensation committee.

One chief executive of a large U.K. company spoke of an increasing concern among nonexecutive directors in that country that management present a fair view of the financial accounts, citing this as one reason for having an audit committee. Some managers and nonexecutive directors in the United Kingdom feel that the diligence of an audit committee can help offset what they consider to be the drawbacks of the customary "letter of representation" that is issued following an audit, a document they feel tends to absolve the auditors of responsibility that should be theirs.

External Influences

While some companies have formed audit committees entirely on their own initiative to meet perceived needs, it is also true that the audit committee is being urged on the corporate world as "good practice" by some influential organizations and individuals, especially in the United Kingdom. In 1983, the Institute of Directors published "The Board and the Auditors," the second of its *Guide to Boardroom Practices* series. (The Institute is an organization that represents the interests of its business-leader membership in the public forum, but also promotes greater competence in managing business enterprise.) As

the excerpt in the accompanying box shows, this publication includes an endorsement by the Institute of the audit committee, and spells out what duties and responsibilities might be assigned to it. Audit committees have also received varying degrees of support in the United Kingdom from the accounting profession, management-consulting firms, individual business leaders, and academic establishments, such as the Oxford Centre for Management Studies. As far back as 1977, in a "White Paper," the government endorsed the idea, and bills for a statutory requirement of audit committees have been proposed more than once in Parliament but have not been enacted.

In a separate but related development, increased exposure of U.K. executives and directors to legal liability has tended to make the "watchdog" aspect of the audit committee attractive: It helps board members monitor finances and public disclosure of accounts, and it is also concrete proof that they are working to do so.

Executives in the Netherlands referred to a somewhat similar situation in that country. In recent years, Dutch society has been shaken by the almost unprecedented occurrence of bank failures and other corporate scandals. While few in number, these incidents have created a climate of concern that has resulted in an emphasis on stricter oversight of corporate affairs by directors (in this case, members of supervisory boards). There is no sign that this situation has led to the establishment of audit committees; very few Dutch companies are believed to have one. Yet the spokesman for a company that *does* have one feels that it shows the firm, which is a financial institution, to be responsible and well managed.

A second external influence that can lead to the use of committees of the board is that of example. Some cooperators said that the idea for a committee of this kind came from a director or manager, who serves as a director of another company and has found a similar committee there to be useful. Boards of U.S. companies or U.S. subsidiaries are one place where such experience has apparently been gained.

Apart from these major factors, other reasons were cited for the decision to establish a board committee. One is the style or preference of the chairman of the board or the company's chief executive. Another is the desire for a confidential forum in which to discuss sensitive issues (such as executive compensation or a proposal for a corporate acquisition). However, this advantage is clearly difficult to attain in those countries where employees below the top management level enjoy membership on board committees.

The Institute of Directors On the Audit Committee

In order to maintain the proper relationship with the auditors, a board must first devise appropriate procedures. They will vary with a company's circumstances, status and size, but it is desirable to ensure in all companies that there should be at least one occasion during each year when the board meets the auditors, to discuss any matters that either party wishes to raise.

In addition, in larger companies the number of issues requiring discussion may make a rather more elaborate procedure desirable. Almost inevitably some element of delegation becomes necessary in these circumstances, and the Institute believes for the reasons set out above that such delegation should not be to the company's management, but to a committee of the board. An increasing proportion of large companies are setting up audit committees, containing a majority of non-executive directors.

The Institute has therefore compiled . . . specimen terms of reference for an audit committee. In addition to its primary purpose—namely to help companies that wish to set up such a committee—it also provides a detailed checklist for all companies of the matters to which the board must give attention in its relationship with the company's auditors.

From: Institute of Directors, *Guide to Boardroom Practice No. 2, The Board and the Auditors*. London, 1984 (revised edition).

Why Companies Have *Not* Established Board Committees

Since many companies, especially in continental European countries, do not have any committees at the board of directors level, the research for this report included an inquiry as to why committees are not used. Cooperators gave two chief reasons:

- *A committee is unnecessary*. Basically, many companies feel no need to set up board committees. They are satisfied that the board, functioning as a group, has sufficient oversight over corporate affairs. In some cases this is made easier because the board is small enough to be cohesive and effective; a committee would be superfluous. Some say that supervisory boards are too limited in their role to make committees worthwhile. In any event, barring a crisis or other unusual circumstance, many boards and managements see no need for committees.
- *Basic incompatibility with the system*. The concept of board committees was described as being potentially at odds with the systems that prevail in Germany and in the Netherlands. In Germany, the membership of the supervisory board has a precise balance that is carefully spelled out in the law; voting procedures are similarly specified in detail, in part so that the board balance will not be undermined. As noted in the box on page 8, the law even provides that the membership of a required committee of the supervisory board will maintain, on a small scale, the balance found on the board as a whole. The labor movement was successful in having declared invalid the use of any form of an executive committee or presidium at the supervisory-board level that would have the effect of diverting broad powers of the board into a forum that would not reflect the balance of the board itself.

In the Netherlands, laws governing the structure of corporate enterprises also provide, although in far less rigid terms than in Germany, that the membership of the supervisory board shall have a balance. In this case, the balance is representation of various segments of society (including shareholders) and it is protected by the mechanism of giving veto power over board

A Required Supervisory Board Committee in Germany: Excerpts from the Co-Determination Act of 1976

From Section 27:

(3) Immediately after the election of the chairman of the supervisory board and his deputy the supervisory board shall form a committee to look after the duties designated to the board in Section 31 subsection 3 sentence 1. The chairman of the supervisory board [who is from the shareholder side], his deputy [who is from the labor side] as well as two members, one each elected by the majority of the votes cast by the members of the supervisory board from the labor side and members of the supervisory board from the shareholders side, belong to this committee.

From Section 31:

(2) The supervisory board appoints the members of the body entitled to legally represent the company [the management board] by a majority which comprises at least two-thirds of the votes of its members.

(3) If an appointment according to subsection 2 is not achieved, the committee of the supervisory board designated in Section 27 subsection 3 shall make a proposal to the supervisory board for the appointment within one month after the ballot in which the majority prescribed by subsection 2 was not achieved; this proposal does not exclude other proposals.

From: Dr. Martin Peltzer, *Co-determination Act 1976*. German-English Text of the Co-determination Act with an Introduction in English. Cologne, O. Schmidt, 1976.

candidates to shareholders, management and nonmanagement employees. One observer there voiced the opinion that such committees have been used sparingly because a committee has the potential for violating the concept of balanced participation that is required in the full board.

Sweden, too, provides a somewhat similar example. In that country, nonmanagement employees of most companies have the right to two seats on the board, although the limit of two board seats means that they are always in the minority. On the other hand, their presence is very significant because they sit on a board that has full powers over corporate affairs. This makes the Swedish worker director a direct participant in corporate planning and decision making. Recognizing that this participation could be blunted if significant matters were delegated or assigned to board committees that did not include worker directors, the law provides that workers who are board members cannot be excluded from the deliberations of any board committees.

Chapter 4
The Role of Board Committees

Why a company has established a committee or committees of the board has less significance, especially in the long run, than the question of what specific role those committees play—what they actually do. This inquiry approached the role of committees in two ways. One was to put the question in general terms, asking whether the reported board committees deal with a function or functions already performed by the board, or whether they perform new board-level roles. The responses to this question are shown in Table 3.

The table indicates that a majority of the committees studied participate in a function that the board as a whole performs as part of its regular duties. In other words, most committees are set up to help the board get its traditional job done. The actual function, level of activity, and extent of authority of committees of this kind range from information gathering (so as to better inform the board), to analysis and recommendation, even to deciding on behalf of the board. Regardless of their scope, these committees have the effect of enhancing the full board's customary oversight role; they do not change it.

The other committees in the survey either focus on an occasional or infrequent board concern or deal with something the board was not previously addressing. In these cases, the committee is broadening or stretching the board's sphere of involvement.

The second series of questions about committee roles established whether each committee reported:

- serves the board in an advisory capacity;
- makes decisions affecting its assigned area;
- serves *management* in an advisory capacity;
- has a monitoring or appraising role;
- has a fact-finding role;
- sets or establishes policy in its assigned area.

These categories serve as rough indicators not only of the functions of board committees but also of the authority that is delegated to them. Summary information for the 31 committees for which it was provided appears in Table 4.

The table makes it apparent that a majority of these board committees play a relatively active role; they are not simply listening posts for the full board. The table also shows that these committees are potentially influential, since in many cases the full board relies on their advice and recommendations, and since a third of them have the delegated authority to decide or act on at least some matters.

Thus, the use of committees would seem to constitute a significant change in how a board carries out its responsibilities. It might be described as an organizational development that

Table 3: Role of Board Committees (in general terms)

	Number of Committees that:		
	Perform or enlarge upon a function also dealt with by the board as a whole on a regular basis	*Perform a function only irregularly dealt with by the board previously*	*Respond to a particular need not previously dealt with by the board*
France	5	1	0
Germany	5	1	1
Netherlands	3	0	1
Sweden	1	3	1
United Kingdom	4	1	3
Total	18	6	6

Table 4: Types of Functions of Board Committees[1]

Country	Number of Committees Reported Having Each Function: Advisory to Board, Recommendations	Makes Decisions	Advisory to Management	Monitors, Appraises	Fact Finding	Sets Policy
France	3	2	3	—	—	1
Germany	—	2	1	1	1	—
Netherlands	4	—	1	2	2	—
Sweden	2	1	3	—	—	1
United Kingdom	10	6	1	5	2	1

[1]Based on 31 committees; multiple responses.

Table 5: Types of Functions of the Three Most Common Board Committees

Types of Committee and Functions	Number of Committees for which Function is Cited
Remuneration or Compensation Committee (7 Committees)	
Advisory to the full board	5
Makes at least some decisions	3
Monitors, appraises	1
Finance or Credit Committee (8 Committees)	
Makes at least some decisions	4
Advisory to management	4
Advisory to the full board	2
Sets policy	2
Monitors, appraises	2
Fact finding	1
Audit Committee (5 Committees)	
Advisory to the full board	4
Monitors, appraises	3
Fact finding	2
Advisory to management	1

enables directors to be better informed and more effective in their roles as board members. Still, as previously noted, thus far it has suited only a minority of European firms to establish a board committee.

Table 5 shows the kinds of functions that were cited for the three most common committees of the board: remuneration, finance and audit. The broadest range of activities is found among finance committees, which also are most often mentioned as having decision-making and policy-setting authority.

Finance committees also are far more likely to serve in an advisory capacity to management than are the other two committees, most of which have the primary task, as the table shows, of advising their fellow board members. The reasons for this difference are simple enough. In the case of the remuneration committee, the task of passing judgment on what top managers are to be paid makes the idea of advising with those managers on that subject illogical. (These committees customarily deal *only* with *top* management compensation.) And an audit committee's chief reason for existence is to give financial accounting, controls and disclosure an overview that is independent of management's.

Remuneration Committees

None of the reporting German companies has a committee at the supervisory-board level that is primarily a remuneration committee. One French firm has a Senior Executive Salaries Committee (Comité des Traitements) but did not describe its function.

Three Netherlands cooperators have compensation committees at the supervisory-board level. All three committees deal with the pay of members of the management or executive board; one also deals with the compensation of presidents of divisions and two key functional executives (finance and research and

development). The two firms that specify the committee's role say it is advisory to the supervisory board, making recommendations that are presented for the board's approval. One of these cooperators points out that in fulfilling this responsibility the committee appraises or evaluates the performance of those executives who are subject to its recommendations, and that other terms or conditions of employment besides compensation are covered in the committee's recommendations. Two of these Dutch remuneration committees are relatively early board committees, having been formed prior to 1970; the third dates from 1983.

Only one Swedish firm has a board committee devoted solely to compensation, but two others have a "presidium" of board members that deals with compensation as well as other matters. The first example, called a Salary Committee, is chaired by the chairman of the board, who is always a nonexecutive director in Sweden. For purposes of establishing the pay level of the company's president and group chief executive, the board chairman serves as a committee of one; the GCE becomes the second committee member for deciding on compensation of group executives. As for the two cases involving a presidium, one advises the board on "key salaries"; the other does the same for "executive management."

Four companies in the United Kingdom have committees dealing specifically with compensation matters. One of these companies actually has two such committees, one called a Remuneration Committee and the other called the Directors' Committee on Profit Sharing and Share Option Schemes.

The role of one of the U.K. committees is described only as "dealing with remuneration of executive directors"; the committee consists of all the nonexecutive board members. Three of the remaining committees are described as advisory to the board regarding top-executive pay. One of these committees also has the power to authorize pensions to be paid to senior management (see above box). Another committee reports its recommendations to a kind of executive committee, rather than directly to the board. Finally, the profit-sharing committee referred to has considerable authority to decide on matters within its scope, as indicated in the following excerpt from the enabling board resolution:

> "...do all such acts and things as may be necessary in connection with the profit sharing option schemes, and in particular...to allot shares, and to make application to The Stock Exchange for new shares..."

It is clear that a major purpose for establishing remuneration committees is to put the setting, or at least the approval, of the pay levels of top management into more neutral hands, instead of leaving those executives to set their own compensation. Not surprisingly, the membership of these committees runs heavily to nonexecutive directors. If there is an insider, it is likely to be the chief executive, who typically absents himself from committee meetings when his own compensation is being discussed.

Apart from the concern about minimizing the conflict of interest that exists when executives have control over their own compensation, there is at least one other motivation for setting up a remuneration committee. The chairman of an industrial firm in the United Kingdom confirmed that without a committee of outside directors, with whom sensitive questions of executive pay and performance can be discussed openly, the chief executive is sometimes in a lonely and frustrating position. A board committee can provide a much-needed forum for talking about such matters in a way that might not be possible with the board as a whole.

Terms of Reference of a Remuneration Committee (U.K. Bank)

The business of the committee shall be:

(a) to consider from time to time, and make recommendations with regard to any matters in connection with the terms of service, benefits or pension arrangements of: (i) Directors of the Bank (Board fees excluded); (ii) Former directors of the bank and widows of former directors; (iii) Senior management in the Bank group, within limits defined from time to time by the board.

(b) to authorise increases in pensions paid to those in (a) (i) and ii) above.

Finance Committees

None of the Netherlands companies has a finance committee at the supervisory-board level. But there are at least two examples of such a committee in each of the other countries. (For purposes of this report, committees that deal with credit matters are considered to be finance committees.)

Both the French finance committees reported are those of a large bank. One, the Comité Consultatif des Engagements, is a very active committee that meets approximately weekly to consider new or proposed credit and loan risks. Its two functions are to advise management on these exposures to risk and to approve (or disapprove) specific applications. The other committee, as its name suggests (Comité Annuel des Risques), meets once a year to consider the overall credit and loan status of the bank as of the end of the year. It presents its findings, broken down by groups and also sectors and countries, to the full board and plays an advisory role to the board.

Three kinds of finance committees at the supervisory-board level are reported by German firms. However, two of these are found in the same industrial company. The company did not spell out the role of these committees, but their names are clearly indicative of their areas of concern. There is a nine-member Bilanzausschuss (balance sheet committee) that meets once a year and makes an oral report to the supervisory board, and an Investitionsausschuss (capital expenditure or appropriations committee) with eight members, that also meets once annually and reports orally to the full board.

The third German supervisory-board committee is a bank's lending committee. To quote the representative of this bank: "German banking law requires approval of the Supervisory Board for certain credit transactions. In the banking industry

it is common practice to delegate these functions to a board committee." (See accompanying box.)

The credit committee, then, while not required by law, has been adopted by some bank supervisory boards as an efficient way of carrying out one of its legal responsibilities. The credit committee of this particular bank has some authority to act, so that the committee can meet the requirements of the law.

The use of a committee for this purpose, as opposed to having the entire supervisory board perform this function directly, is very practical when the frequency of credit decisions in a major bank is taken into account. In a recent year, this particular committee met four times, but its members dealt with numerous additional decisions in writing. It would obviously be difficult for the full board to function at this level of activity. A detailed description of this committee's role follows:

"(1) The committee receives regular and detailed reports on the bank's complete credit activities.

"(2) The committee and management discuss the bank's policy in respect to certain branches, countries, customers and special situations. [The committee's role here is advisory to management.]

"(3) The committee decides upon those credit transactions which under the German Banking Act are subject to the approval of the supervisory board; in addition, the committee decides upon certain transactions in holdings which under the bank's own statutes are subject to board approval." [Here the committee decides or acts on behalf of the board.]

The committee has three members (plus an alternate). It normally reports to the full board on its activities once a year.

In Sweden, two industrial companies reported having finance committees. Both of these committees have five members; at one, one of the five is an insider (executive or employee of the company), while two of the five are insiders at the other. One of these committees has the role of advising management on corporate investment decisions, and requires from eight to ten meetings a year to do this. The other committee has considerably broader terms of reference and deals with financial guidelines, key financial questions, and a review of corporate financial results. Like the first committee, this one advises management on these matters, but it also has authority to establish policy on some of them (which ones were not specified).

There are two U.K. board committees whose sole or primary concern is financial. A consumer products company has a Finance Committee with broad terms of reference covering financial policy and major financial decisions, in particular treasury control measures and significant capital investment items. Its specific role in these matters was not described. All members of this committee, except one, are inside or executive directors.

An industrial company in the United Kingdom has a Finance and General Purposes Committee. Basically, this committee reviews important financial matters; it monitors them and is advisory to the board. However, it also has delegated to it the power to act on behalf of the board, and this makes it especially valuable at times, according to the company's chairman. An example he gave was the ability to respond to an acquisition opportunity in only three days' time because the Finance and General Purposes Committee could be convened quickly to give its approval of the project. There was then time to contact all other members of the board to inform them of the decision and to provide them with details. This canvassing of the entire board, some of whom are not U.K. residents, could not have been done with sufficient speed and thoroughness to meet the need for a prompt decision in this situation. This chairman emphasized that there was a clear understanding by board members that the committee could take action, and that the full board's powers were not being improperly assumed by the committee for the sake of expediency.

Description of the Role of a Lending Committee[1] (Germany)

"During the year under review the Supervisory Board, both directly and through its own committees, maintained regular contact with the management, at meetings and in discussions, regarding the management and performance of the bank.

"The Lending Committee of the Supervisory Board has dealt individually with those loan commitments which require [the board's] approval under German banking legislation, and has additionally given consideration at its meetings to all the larger loans and those involving enhanced risks, and discussed these with the management. In doing so, it has paid attention to the after-effects of the recession, to the risks attaching to individual economic sectors and countries, and to the structural changes in the domestic and international sphere."

[1]From the report of the Supervisory Board, part of the annual report of a German bank. (Certain insignificant changes made.)

At least one other U.K. company provides for board-committee attention to financial matters, even though it does not have a financial committee as such. The company's Executive Committee has the power

> "...to approve capital expenditures within plan on fixed assets or investments up to a maximum of 5 million pounds on a single project and to recommend proposals above this level for board approval;
>
> "...to approve appropriate levels of authority for fixed asset expenditure available to sectoral management committees and individuals."

Audit Committees

Of the five companies reporting an audit committee, one is French, two are Dutch, and two are British. No audit committees were reported from Germany or Sweden.

The French company's Comité des Comptes has seven members, only one of whom is a company executive. The committee meets three or four times a year, especially at the time of approval of financial statements, and reports orally to the full board. The approval of the financial statements comes from

Duties of the Audit Committee of a Bank in the U.K.

The business of the committee in respect of the Bank and its principal subsidiaries shall be:

(a) To review the adequacy of the internal control system of the Bank by:
  (i) receiving an annual report from the Group Chief Executive;
  (ii) receiving presentations from the Group Chief Executive or his nominated representative from time to time on specific issues of internal control;
  (iii) discussion with the internal and external auditors about the scope and nature of their work; and
  (iv) calling for such further investigations as are necessary to assure themselves of the effectiveness of the systems of control throughout the Group.

(b) To meet with the external auditors to review:
  (i) the level of audit fees;
  (ii) the proposed audit coverage, and the proposed range of work carried out by Bank staff;
  (iii) the level and grade of audit staff employed, and the extent of continuity in staffing;
  (iv) the effects on the level of audit work carried out of changes in the system of internal controls; and
  (v) the financial statements as below.

(c) To meet with the Head of Group Audit to review:
  (i) the objectives, plans and policy of the internal audit department;
  (ii) the quality of internal audit personnel and the training available to them;
  (iii) the proposed and actual audit coverage;
  (iv) the number and availability of staff, and any limitations on the work carried out imposed by the department budget; and
  (v) any findings.

(d) To review the annual and half-yearly financial statements, considering:
  (i) any changes in the published accounting policies of the Group and the reason for and effects of the change;
  (ii) the degree of conformity with the accounting policies generally followed in the industry;
  (iii) any sensitive reporting or accounting practices;
  (iv) any proposed adjustments not implemented and the reasons for non-implementation;
  (v) any unusual transactions;
  (vi) the possible effects of any proposed changes in government legislation, etc;
  (vii) any alternative methods of disclosure; and
  (viii) any matters referred to the committee from the Chairman's Committee.

(e) To meet with the external auditors to review the management letters arising from the audit of the Bank and its subsidiaries and to discuss with the Group Chief Executive and his nominated Executives the work carried out to implement agreed solutions.

the board; the committee's basic role is an advisory one, both to the board and to the company's management.

A Dutch bank has established one of the audit committees reported in that country. It was created in 1985. A spokesman said that informal research done by the bank prior to setting up its audit committee confirmed that such committees are rare in the Netherlands. Since it is a committee of the supervisory board, none of its four members is a company employee. It is intended that the committee will meet twice a year and report in writing to the supervisory board after each committee meeting. Its role is to advise the board; it is expected that the committee will hold in-depth discussions on yearly and half-yearly financial results, and on the management letter and the external auditor's report in regard to those results.

The other Netherlands committee is actually called the Special Committee, and has more than one function. It considers important matters that will affect the company, acting in an advisory capacity to the board of management on these issues. But it is also an audit committee; half of its meetings are specifically devoted to this function (in which it is chiefly a fact-finding body for the supervisory board). The committee has four members and meets four times yearly.

In the United Kingdom, one of the audit committees was established in 1977 at a bank. It presently consists of three nonexecutive directors and meets four times a year. The committee selects its own chairman. The bank's board chairman (an executive) is entitled to attend meetings of this committee, but other executives and representatives of the outside auditing firm are also frequently in attendance. This committee's detailed terms of reference, as expressed in a resolution of the board, are presented in the above box.

The other U.K. audit committee, that of an industrial company, dates from 1974. It meets twice a year and reviews financial reports and accounts prepared by management, acting as an advisory body to the full board in connection with its findings.

Chapter 5
Membership and Procedures

This section examines the makeup of the reported board committees—their size, and the relative extent to which outside and inside directors are represented on them. Also dealt with are the selection process for committee members and chairmen, and the frequency with which committees meet and with which they report to the full board on their activities.

Committee Size

The following tabulation of the most common committee sizes (those that occur more than once) shows that while a three-member committee is by far the most popular configuration in the sample, a slight majority of the committees have *more than three* members:

Committee Size	Number of Times Mentioned, All Countries
2 members	3
3 "	12
4 "	5
5 "	3
7 "	4
10 "	2
Total committees[1]	29

[1]Excludes four committees whose size was mentioned only once, and seven committees for which no information is given.

Committee size does vary somewhat from one country to the next, as Table 6 suggests. The median committee sizes are similar except for France—where the median is 10, and committee size goes as high as 20 members.

Outside-Inside Representation

Table 6 also presents information about the relative representation of outside (nonemployee) directors and inside directors (executives or other employees) on these board committees. As the last line of the table shows, outside directors are in the majority on most committees.

This is not surprising, since outside directors are in the majority on most of the boards of the 18 companies that provided information. This is a matter of legal requirements in four countries represented in the report. The supervisory boards of Dutch corporations have *no* executives or other employees. Therefore, all five Dutch committees have only outsiders on them. Swedish and French boards also have mandatory majorities of outsiders. And while German supervisory boards are composed one-half of employees, they are not executives, or at least not members of the management board.

Whatever the reasons for their composition, the makeup of these committees clearly distinguishes them from *management* committees.

Selection of Committee Members and Chairmen

Cooperators were asked to state who chooses the directors to serve on their board committees, and to indicate how committee chairmen were chosen. In a majority of cases, the board

Table 6: Size and Other Information for 36 Board Committees

	France	*Germany*	*Netherlands*	*Sweden*	*United Kingdom*
Number of committees	5	7	5	5	14
Range of committee size (members)	7-20	3-9	3-4	1-5	2-10
Median committee size	10	3	4	4	3
Number of committees having a majority of nonemployee directors	3	7	5	5	6[a]

[a]Information available for only 11 of 14 committees

Table 7: Frequency of Board Committee Meetings, 31 Committees

	Number of Committees				
	France	*Germany*	*Netherlands*	*Sweden*	*United Kingdom*
	3	5	6	5	12
Range of meeting frequencies	3-12	1-4	1-4	1-10	1-24
Average (mean) number of meetings per year	7.0	2.2	2.5	4.4	6.5

as a whole appoints members of board committees. That is how membership of 26 of the 40 committees is decided. The chairman of the board makes the selection in most of the other cases; in one French company, the president does it.

Committee chairmanships follow a different selection process. For sixteen committees, the chairman is a choice of the full board; in seven cases the chairman of the board automatically serves as committee chairman (in an eighth company it is the president-chief executive who serves); five committees determine for themselves who the chairman shall be; and the board chairman picks committee chairmen in three cases. (The selection process could not be determined for eight committees.)

Several of the committees have a membership structure that is a predetermined combination of the incumbents of specified corporate positions. An example can be cited from a bank in the United Kingdom, whose Chairman's Committee has the following predesignated membership, as spelled out in a board resolution:

> Chairman of the Board
> Deputy Chairmen
> Group Chief Executive
> Deputy Chief Group Executive
> Two nonexecutive directors (with alternates) rotating each year.

A few other firms use some kind of rotation system for committee membership. Such a system spreads committee service evenly among board members over time, giving all directors a chance to serve on key committees. It can also help to prevent any group of directors from becoming entrenched in key committee positions.

Only a few cooperators commented on criteria used in selecting which directors shall serve on board committees. The chairman of a U.K. industrial company with three board committees said that he tries to keep a balance of experience and background on those committees, which is a goal mentioned by some others. In the case of audit committees, there seems to be a consensus that this committee should be staffed with experienced directors, who can be independent-minded and who will ask probing questions when necessary. A consideration for candidacy for membership on some active executive committees would appear to be the ability to attend meetings between board meetings, or meetings called on short notice.

Committee Meetings

The tabulation below shows the most common meeting frequencies—those reported more than once—of committees in the five countries. Note that about half the committees meet either once or four times yearly.

Frequency of Meetings	Number of Times Mentioned, All Countries
1 meeting(s) a year	7
2 " " "	5
3 " " "	5
4 " " "	7
5 " " "	2
12 " " "	2

The figures in Table 7 indicate that German and Dutch committees in the sample group meet less often than do committees in the other countries, on average. These and other figures in the table appear to reflect a connection with the relative frequency of *board* meetings in the respective countries. For example, German and Dutch supervisory boards customarily meet four or five times a year, which is less often than boards in the other countries covered in the report.

Among the most active committees in the survey are a French credit committee, in a financial institution, that meets as often as fifty times a year; a German credit committee (also in a financial institution) that convenes four times but acts thirty or more times a year by means of written consent; an all-insider executive committee (United Kingdom) that meets twenty-four times; and a Swedish finance (investment) committee that holds as many as ten meetings a year.

Interview comments suggest that committee meetings are instrumental in creating useful interchanges between members of the board and members of management. A three-member audit committee in a U.K. financial institution—the members are all senior nonexecutive directors—sometimes meets with as many as a dozen people present, the others being senior managers who attend by invitation. One of these managers is likely to be the chief internal auditor. Similarly, the internal auditor of a bank in the Netherlands customarily attends meetings of the audit committee and, in fact, serves as recording secretary at meetings.

Table 8: Board Committee Reports to the Full Board, by Country

Number of Committees Providing Information	Number of Board Committees that Customarily Report Their Activities			Reporting Method Used by Committees that Report	
	Yes	No	No Answer	Oral	Written
France (6 committees)	2	3	1	2	0
Germany (7 committees)	5	1	1	5	0
Netherlands (6 committees)	6	0	0	4	2
Sweden (6 committees)	2	2	2	N/A	N/A
United Kingdom (15 committees)	12	2	1	2	4 (6 = N/A)
	27	8	5	13	6

Other instances were cited in which board committee meetings provide a conduit of communication between the board and management. A U.K. board's executive committee sometimes meets jointly with its counterpart at the management level, a process that occasionally results in joint proposals or recommendations to the full board. In a Netherlands industrial concern, it is customary for committees of the supervisory board to meet at times with the management board, in particular regarding the annual report and other matters subject to supervisory-board approval. The discussion and exchange of information at these meetings later help the supervisory-board members to arrive at a decision.

On the other hand, there are times when the presence of management at a board committee meeting is inappropriate. It is common practice for an audit committee to confer with representatives of the outside accounting firm without any member of management being present (the committee members, as a rule, are nonexecutive directors), so that the auditors can speak without inhibition. Some audit committees also meet with the internal auditor privately so that this executive has an opportunity to raise potentially sensitive issues without the intimidating presence of top management.

Committee Reports to the Board

Table 8 shows that most, although by no means all, of the surveyed board committees report on their activities to the full board. The table also indicates that two-thirds of those committees that do report to the board, do so orally rather than in writing. This simply means that the committee chairman is asked to inform the board of the committee's activities since the last report. Where a written report is submitted, it is usually in the form of minutes of the committee's meeting(s).

The frequency with which committees report to the full board varies considerably. Three approaches suggest themselves, based on survey responses:

- At prescribed intervals (once a year, five times a year, every three weeks);
- At a specific time, such as when financial statements must be approved for the year, or at the first board meeting following a committee meeting;
- As needed, which might vary according to the committee's level of activity or the importance or timeliness of its deliberations.

Related Conference Board Publications

	Report No.
Corporate Directors' Compensation, 1986 Edition	877
Corporate Directorship Practices: The Compensation Committee	829
Corporate Directorship Practices: The Nominating Committee and the Director Selection Process	812
Corporate Directorship Practices: The Planning Committee	810
Corporate Directorship Practices: The Public Policy Committee	775
Corporate Directorship Practices: The Audit Committee	766
The Board of Directors: Perspectives and Practices in Nine Countries	728
Corporate Directorship Practices: Role, Selection and Legal Status of the Board	646
Corporate Directorship Practices: Retirement Pay and Deferred Compensation for Outside Directors	RB115
Corporate Directorship Practices: Uncommon Committees of the Board	RB139
The Role of Outside Directors in Major Acquisitions or Sales	RB180